REGULATORY FLEXIBILITY COMMITTEE

Legislative Services Agency
200 West Washington Street, Suite 301
Indianapolis, Indiana 46204-2789
Tel: (317) 233-0696 Fax: (317) 232-2554

Authority: IC 8-1-2.6-4

MEETING MINUTES[1]

Meeting Date:	**October 30, 2003**
Meeting Time:	**1:30 P.M.**
Meeting Place:	**State House, 200 W. Washington St., Room 431**
Meeting City:	**Indianapolis, Indiana**
Meeting Number:	**3**

Members Present: **Rep. Dan Stevenson, Co-Chairperson; Rep. Terri Austin; Rep. Ryan Dvorak; Rep. Scott Pelath; Rep. Scott Reske; Rep. Jack Lutz; Rep. David Frizzell; Rep. Brooks LaPlante; Sen. James Merritt, Co-Chairperson; Sen. Beverly Gard; Sen.Brandt Hershman; Sen. Timothy Lanane; Sen. Larry Lutz; Sen. Frank Mrvan.**

Members Absent: **Rep. Alan Chowning; Rep. Jerry Denbo; Rep. Craig Fry; Rep.**

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[1] Exhibits and other materials referenced in these minutes can be inspected and copied in the Legislative Information Center in Room 230 of the State House in Indianapolis, Indiana. Requests for copies may be mailed to the Legislative Information Center, Legislative Services Agency, 200 West Washington Street, Indianapolis, IN 46204-2789. A fee of $0.15 per page and mailing costs will be charged for copies. These minutes are also available on the Internet at the General Assembly homepage. The URL address of the General Assembly homepage is http://www.ai.org/legislative/. No fee is charged for viewing, downloading, or printing minutes from the Internet.

Robert Behning; Rep. Michael Murphy; Rep. David Yount; Sen. David Long; Sen.Becky Skillman; Sen. Thomas Wyss; Sen. Lawrence Borst; Sen. Glenn Howard.

Senator James Merritt and Representative Dan Stevenson, Co-Chairmen of the Regulatory Flexibility Committee, convened the meeting at 1:30 p.m. Senator Merritt indicated that the meeting would cover the following topics: (1) bundled telecommunications services; (2) competitive wholesale electricity markets; and (3) net metering policies for alternate energy facilities. He then invited John Koppin to address the issue of bundled telecommunications services.

Bundled Telecommunications Services

Mr. Koppin, President of the Indiana Telecommunications Association (ITA), introduced his organization as a non-profit trade association representing Indiana's telecommunications industry. He noted the diversity of the ITA's membership, which includes local exchange carriers, wireless companies, and other telecommunications companies authorized to do business in Indiana. Despite the sometimes conflicting interests of these diverse constituencies, ITA members have expressed overwhelming support for legislative action with respect to the way the sales tax is applied to bundled telecommunications services.

According to Mr. Koppin, the "bundling" of different telecommunications services into one package that can be offered to meet a customer's various telecommunications needs has become increasingly common. He predicted that with the entrance of local exchange carriers into the long distance market, and with the continued deployment of Indiana's broadband infrastructure, the demand for bundled services will continue to grow. While bundled packages offer consumers the convenience of paying for all of their telecommunications services in one monthly bill, such packages can complicate the billing process for providers when the package contains both taxable and nontaxable services. As more and more customers opt for bundled services, the administrative burden on telecommunications providers is likely to grow.

Mr. Koppin explained that HB 1202 (2003) would have eased this administrative burden by providing that in a sale of bundled services, the part of the services not ordinarily subject to the sales tax is taxable unless the provider can identify the nontaxable part based on the provider's regularly kept books and records. To illustrate the context in which this situation could arise, Mr. Koppin gave the example of a bill that includes charges for monthly local service and intrastate toll service, both of which are taxable, and for interstate long distance service, which is nontaxable. According to Mr. Koppin, HB 1202 would relieve the provider from having to break down the total amount of sales tax due and separately state it for each taxable service on the bill.

Mr. Koppin further noted that the federal Mobile Telecommunications Sourcing Act, which has been adopted in Indiana, already relieves mobile service providers from having to separately state charges for taxable and nontaxable mobile services. HB 1202 would extend this relief to providers of nonmobile services as well. Mr. Koppin pointed out that the books and records of all providers would remain subject to audit.

Although HB 1202 was backed by the ITA's diverse membership and was reported favorably out of the House Ways and Means Committee, it did not receive a hearing in the Senate during the 2003 session. Given the wide support for such legislation and the increasing demand for bundled telecommunications services, Mr. Koppin urged legislators to introduce a similar measure in the 2004 session.

Competitive Wholesale Electricity Markets[2]

Turning the Committee's attention to energy issues, Senator Merritt invited testimony from Freddi Greenberg, Executive Director and General Counsel of the Midwest Independent Power Suppliers (MWIPS). Ms. Greenberg explained that MWIPS is a group of ten wholesale power suppliers serving the Midwest. She indicated that representatives from two MWIPS member companies, Mirant and PSEG, had accompanied her and were available to answer questions.

Ms. Greenberg noted that MWIPS companies have a significant presence in Indiana. Among Indiana's ten operating merchant plants are several projects owned by MWIPS members, including Duke Energy Vermillion (Duke Energy), Sugar Creek Energy (Mirant), and PSEG Lawrenceburg (PSEG). The IURC has approved three additional plants proposed by Duke Energy, Calpine Corporation, and PSEG, respectively.

By way of background, Ms. Greenberg explained that wholesale suppliers sell electricity as a commodity, on either a short- or a long-term basis. However, unlike regulated utilities, such suppliers do not enjoy the benefits of a retail customer base or a guaranteed rate of return. According to Ms. Greenberg, the current wholesale market is the result of a decades-long evolution of the electric industry from a highly regulated system to a more competitive structure. She noted several significant events in this evolution, including the enactment of the Public Utility Regulatory Policies Act (PURPA) of 1978, which required utilities to purchase power from hydroelectric facilities and other "qualifying facilities." PURPA resulted in more players entering the field throughout the1980s, as investments in qualified facilities were made. In 1990, the Clean Air Act introduced a market-based concept to the electric industry by phasing in the trading of emissions credits for certain pollutants. Six years later, the Federal Energy Regulatory Commission (FERC) facilitated the trading of electricity itself by mandating open, nondiscriminatory access to transmission grids. In furtherance of this policy, FERC Order 2000 was issued in 1999 to establish rules for regional transmission organizations (RTOs).

By 1998, merchant power plants had entered the scene as competitors in the wholesale electricity market. According to Ms. Greenberg, the environment that brought about the widespread investment in merchant plants during the late 1990s was markedly different from the regulated, cost-based system in which vertically integrated monopoly utilities owned and operated all facilities for the production, transmission, and distribution of electricity. The regulated, cost-based system had been replaced by today's competitive, risk-based system. Under this new system, competitive generators and marketers supply retail utilities with some or all of the electricity that the utilities sell to their customers.

Noting that today's competitive wholesale market offers benefits even in the absence of retail competition, Ms. Greenberg explained the difference between a regulated, cost-based system and a competitive, risk-based system. In a cost-based system, the regulatory authority regulates the profits of the monopoly utility by regulating the utility's ratebase on a cost-of-service basis. According to Ms. Greenberg, because rates are tied to costs, and because the primary way for regulated utilities to increase their profits is to receive an increase the ratebase, the regulated environment can lead to inflated costs. In

[2]See Exhibit 1.

fact, the cost structure of regulated utilities has risen over the past 80 years, primarily as a result of uneconomic generation investments.

In contrast, in the risk-based wholesale system, profits are regulated by competitive pressures. The principal way for a wholesale provider to be profitable is to be the lowest cost producer and to sell more power. While the pressure in a regulated system is to inflate costs to maintain profitability, the pressure in a market-based system is to decrease costs to minimize customer prices and thereby maintain profitability. According to Ms. Greenberg, this difference in how profits are achieved represents a shift in system risks from the customer to the supplier. In a regulated system, "captive" ratepayers pay the costs of the construction, operation, and maintenance of the monopoly utility's facilities through the ratebase. Therefore, the ratepayers ultimately bear the risk if the utility makes uneconomic investments in generation facilities. However, in a market-based system, owners and investors finance the construction and operation of plants and bear the risks of their own investment decisions and changing market conditions.

After detailing the benefits of the market-based wholesale environment, Ms. Greenberg described the various arrangements that exist between wholesale suppliers and their customers. She noted that competitive wholesalers offer a variety of products and services. Under a "full requirements" arrangement, the wholesale supplier furnishes the retail utility with everything it needs to furnish service to its customers, including energy, capacity, and certain "ancillary" services. Ms. Greenberg explained that ancillary services are those services necessary to effect a transfer of electricity between a seller and a buyer, such as scheduling, system control, and dispatch service. Other arrangements that are less comprehensive than full requirements arrangements are also available. For example, a retail utility and a wholesaler might enter into an energy-only contract (for megawatt hours) or a capacity-only contract (for megawatts).

Ms. Greenberg concluded her presentation by focusing on the future of competition in the electric industry. Noting that market-based systems undergo quick changes in response to market conditions, Ms. Greenberg reported that 300,000 MW of competitive generation has been built or acquired since 1997. During this short period of time, more than 35 utilities have divested nearly 116,000 MW of generation capacity, and more than 20 utilities have transferred 72,000 MW of rate-based generation to competitive affiliates. Stressing again the benefits brought about by these rapid changes, Ms. Greenberg noted that three nuclear power plants have been retired as more competitors have come online. According to Ms. Greenberg, the additional capacity is also responsible for a 27% average reduction in electricity prices for all customers (including wholesale purchasers) since 1985. She pointed out that this overall reduction includes a 31% average decrease in residential prices and a 35% average decrease in industrial prices.

Despite the benefits that the wholesale market has produced, Ms. Greenberg warned that there are significant barriers to the further development of competition. She noted that there is still hostility to competition among traditional utilities, particularly in the Southeast. States in the Northwest, having exported significant amounts of power to California during its failed attempt at retail deregulation, have become wary of competition in any form. In addition, customers are largely unaware of the lower prices wholesale competition has brought about, especially when their bills reflect a bundled rate for various utility services. Finally, the wholesale electricity market struggles with the same challenges that all immature markets face--namely, a lack of buyers and sellers, a shortage of products and transactions, and regulatory uncertainty. The emerging electricity market has been further

hampered by incomplete transmission access and delays in the coordination of RTOs.

Ms. Greenberg cautioned that any efforts toward re-regulation would only shift system costs back to ratepayers. Noting Indiana's forecasted energy shortfall, she suggested that retail utilities should be required to "shop" for the best deal for their ratepayers as they purchase their wholesale requirements. She urged the implementation of competitive procurement procedures, such as wholesale auctions or a request for proposal (RFP) process, in which retail utilities would seek bids from wholesalers. Under an RFP system, for example, the Indiana Utility Regulatory Commission (IURC) could be given oversight over the process, with a neutral third party developing the RFP and scoring the responses.

After listening to these suggestions, Senator Lanane asked whether Ms. Greenberg was seeking legislation to establish competitive procedures. Ms. Greenberg indicated that legislative action was probably not required to implement the recommended practices. She suggested that competitive procurement policies could be established through administrative action.

Representative Dvorak then asked whether all MWIPS members are gas-fired plants. Ms. Greenberg reported that one member has significant coal-burning assets in Illinois. When Ms. Greenberg acknowledged that most merchant plants are gas-fired facilities, Representative Dvorak expressed concern about Indiana becoming too reliant upon these facilities, given the uncertainty surrounding natural gas prices and supplies. Ms. Greenberg responded that there is no evidence that merchant plants are responsible for any perceived crisis in the natural gas industry. She noted that as consumers of natural gas, merchant plants suffer just as retail customers do when prices rise.

In response to a question from Representative Pelath about the "ideal" location for a merchant power plant, Ms. Greenberg explained that merchant plants tend to locate near existing transmission facilities, natural gas pipelines, and water sources. Investors also look to where there is need in the market when making siting decisions.

Net Metering Policies

Following the discussion of the wholesale electricity market, Senator Merritt shifted the meeting's focus to retail sales by inviting Chairman William McCarty of the IURC to discuss Indiana's net metering policies for alternate energy facilities. Chairman McCarty explained that net metering is a billing arrangement between a utility and a customer who has installed certain alternate energy equipment, such as a solar, wind, hydroelectric, or fuel cell generator system. Under a net metering arrangement, the customer remains connected to the electricity grid and is billed for the difference between the amount of electricity supplied by the utility to the customer and the amount of electricity generated by the customer and delivered to the utility. If the kWh delivered by the utility to the customer exceeds the kWh delivered by the customer to the utility during the billing period, the customer is billed for the kWh difference. However, if the kWh generated by the customer and delivered to the utility exceeds the kWh supplied by the utility to the customer, the customer is credited in the next billing cycle for the kWh difference. Chairman McCarty noted that the credit is calculated on a kWh basis and not a cash basis. Therefore, a customer will never receive a cash refund for any excess power delivered back to the utility. He also stressed that in a net metering arrangement, the customer's generation is

intended primarily to offset part or all of the customer's requirements for electricity. Because the power returned by the customer is usually of an insignificant and unpredictable amount, it is not meant to serve as an additional source of supply for the utility.

Chairman McCarty emphasized that net metering is still in its early stages in Indiana, with three investor-owned utilities--IPL, SIGECO, and PSI Energy--currently offering net metering contract riders.[3] He noted that the IURC held a technical workshop on distributed resources and net metering in May 2002. After soliciting and receiving comments on these topics before and during the workshop, the IURC Electricity Division circulated a draft rule[4] on net metering to interested parties in June 2003. It has since received comments on Draft 1 of the proposed rule and has taken the comments under advisement. The IURC plans to initiate the formal rulemaking process by publishing a notice of the proposed rule in December 2003.

According to chairman McCarty, one of the proposed rule's most important provisions requires an electric utility and a net metering customer to execute a "standard interconnection agreement" before the net metering facility may be interconnected with the electric utility's system. Chairman McCarty explained that interconnection involves the physical, "parallel" connection of the net metering facility with a distribution facility of the utility. Because a parallel arrangement allows the instantaneous flow of electricity to automatically occur in either direction between the net metering facility and the utility's distribution facility, it is important that the equipment involved be properly installed and maintained. Accordingly, the rule would require the net metering customer to provide the utility with proof of the qualified installation of the net metering facility, such as a certification from a licensed electrician. The rule would also give a utility discretion to isolate any net metering facility if the utility believes continued interconnection would create or contribute to a system emergency.

In response to a question from Senator Lanane about equipment costs, Chairman McCarty indicated that the customer is responsible for all capital costs of the alternative generation system, including installation. In closing his remarks, Chairman McCarty noted that the IURC had published a white paper on distributed generation and offered to supply a copy to interested Committee members.

Following Chairman McCarty's presentation, Grant Smith of the Citizens Action Coalition highlighted the benefits of distributed generation and urged legislators to provide incentives for net metering. He noted that the three utilities offering net metering currently limit individual customer capacity to systems with ratings of 10 kWh or less. Each utility also caps the total capacity for all net metering customers, with IPL imposing a 1 MW systemwide cap, SIGECO imposing a 1.2 MW cap, and PSI Energy imposing a 10 MW cap. Mr. Smith explained that other states that have adopted net metering rules have specified in those rules the systemwide cap that utilities must impose. For example, in California, each utility that is required to participate in net metering must use a 1 MW systemwide cap. In New Jersey, a utility must use a 2MW systemwide cap. Mr. Smith noted that Indiana's draft rule does not specify a systemwide capacity cap that each utility must adopt. However, the rule would allow a utility to limit the aggregate amount of net metering capacity to 0.1% of the utility's most recent summer peak load. Mr. Smith suggested that a 2MW cap would be feasible for Indiana utilities, given the available

[3]See Exhibits 2, 3, and 4.

[4]See Exhibit 5.

transmission facilities and recent demand history.

Senator Hershman expressed concern about the length of time needed for customers to recoup their initial capital costs through a net metering arrangement. Mr. Smith acknowledged that the time needed to recoup costs is significant, especially for solar systems. He suggested that the considerable equipment costs associated with alternate energy systems is one reason why policymakers should offer incentives for investments in such facilities.

Mr. Smith then turned the discussion over to Derrick Adkins, President of Wolfsong Wind Systems. Mr. Adkins explained that his company maintains six wind systems in northern Indiana. Noting that over 30 states have adopted net metering laws, he urged Indiana to update its existing net metering rules, which he called "outdated." Expressing his support for the inclusion of a 2MW capacity cap in the IURC's proposed rule, he also suggested that a utility be allowed to limit net metering availability only when the utility's total net metering capacity reaches 1% of the utility's most recent summer peak load, rather than the 0.1% threshold contained in the draft rule.

In response to a question from Representative Frizzell about equipment costs, Mr. Adkins indicated that a 10MW generation unit costs about $40,000, including installation. He noted that the typical wind system has a 20-year useful life. When asked by Representative Reske about the standard rotor diameter for a unit, Mr. Adkins replied that a 750 kW unit has a rotor diameter of 150 to 200 feet.

With no further questions from the Committee, Mr. Adkins concluded his remarks. Senator Merritt then thanked the Committee for its work during the interim and adjourned the meeting at approximately 3:45 p.m.